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E.O. 12958: DECL: 10/19/2017
TAGS: EFIN ECON RS
SUBJECT: UPDATE ON PWC'S YUKOS, RUSSIAN TAX CASES

REF: A. MOSCOW 1210

¶B. MOSCOW 466

Classified By: ECON M/C Eric T. Schultz, Reasons 1.4 (b/d).

Summary

¶1. (C) PricewaterhouseCoopers (PWC) President for Central/Eastern Europe and the CIS Mike Kubena (Amcit) and Managing Partner of PWC for Russia Peter Gerendasi implied that the YUKOS and expatriate salary tax cases against the auditor were politically motivated. Kubena suggested that the YUKOS case, which is based on the charge that the auditor colluded with the former oil giant to defraud the government, may be an effort by the GOR to prove ex post facto that its actions against YUKOS had a legitimate basis. He explained that using the legal system would allow the GOR to demonstrate that not only did YUKOS evade taxes it used the help of an international auditing firm to do so. He noted, moreover, that the Prosecutor General had found in favor of PWC in a related YUKOS matter in July. Gerendasi suggested that the case alleging PWC illegally deducted its expatriate employees salary expenses in 2002 would show that the former YUKOS auditor played fast and loose with the rules. This latter case, for which PWC has already paid the USD 15 million in back taxes the Federal Tax Service claimed were owed, prompted the Interior Ministry to initiate a criminal investigation in February. Gerendasi said that while Russia is a growing part of PWC's global business it constituted about 1 percent of total revenue and that the persistence of the criminal case and additional tax penalties might push the auditor to close its operations in Russia. End Summary.

YUKOS Case: "Politically motivated"

¶2. (C) During a meeting October 19 with EconMinCouns, PricewaterhouseCoopers (PWC) President for Central/Eastern Europe and the CIS Mike Kubena (Amcit, protect) and Managing Partner of PWC for Russia Peter Gerendasi summarized the status of the two ongoing court cases their company faces. The first case centers on a Federal Tax Service (FTS) allegation that PWC colluded with YUKOS to defraud the Russian government of billions in tax revenue (Ref A). On October 12, an appellate court upheld the FTS position on the issue. The court also ruled that FTS officials should be granted access to the personnel files of all PWC employees worldwide in an effort to determine the extent of the former

oil giant's tax evasion schemes. (Note: This would give tax authorities access to approximately 150,000 employees working in more than 150 offices around the world. End Note.)

¶3. (C) Kubena speculated that the GOR may be trying to justify its dismantling of YUKOS ex post facto by proving in the courts that an internationally recognized auditing firm aided and abetted the former oil giant's tax evasion. Kubena pointed out, however, that the Prosecutor General's Office issued a formal finding in July that YUKOS managers had deliberately deceived PWC's auditors. The Prosecutor General's finding also stated that no evidence existed to show PWC had colluded with YUKOS to defraud the GOR.

Tax Case: Smear Campaign

¶4. (C) The second case centers on an allegation that PWC illegally deducted approximately USD 15 million in expatriate salary expenses in 2002 (Ref B). After PWC lost the first and appellate instances, the Interior Ministry initiated a criminal investigation, which has been extended four times, according to Gerendasi, while officials "interrogate our staff and look for a smoking gun." The Supreme Arbitration Court heard PWC's appeal in July and in a victory for PWC, remanded the case to a lower court, having found that the Federal Tax Service officials improperly used sample data in their determination that PWC had illegally deducted its expatriate salary expenses. However, in September, the Federal Arbitration Court that heard the remanded case once more upheld the Federal Tax Service's position.

¶5. (C) Gerendasi explained that before the SAC heard the case, PWC was required by law to pay the amount of back taxes due since the auditor lost in the appellate instances. He said that the Federal Tax Service also began an audit of PWC's operations in 2003-05 and that the preliminary estimates of the taxes due on expatriate salaries from that period could be USD 45 million or more. He suggested that tax and law enforcement authorities may be trying to cast PWC as reckless in an attempt to underscore that the GOR rightfully prosecuted YUKOS senior management. Gerendasi also observed that although Russia forms an "important part of PWC's global business," the USD 225 million in business amounts to approximately 1 percent of its annual worldwide turnover. He stated that the imposition of additional fines might push PWC to end its operations in Russia.

Comment

¶6. (C) Kubena and Gerendasi made a credible case that PWC's legal travails lacked a strong basis in law and accounting standards. For example, the appellate court ruling on the YUKOS case appears to lack judicial seriousness. The judge's call for wholesale access to PWC's worldwide personnel files fails to incorporate consideration of the legal restrictions on access to personal employment information in the various jurisdictions where PWC operates. Regardless of the facts, PWC is under serious duress in Russia. How serious is not clear given the conflicting signals sent by the Prosecutor General's office and the appellate ruling on YUKOS. Moreover, PWC is not without allies. It has a wide range of clients, representing some 60 percent of Russian GDP, for its auditing services, including Gazprom and the Central Bank. For the moment PWC is considering its options and promised to keep us informed of developments.
Burns